

Internal Audit of Year-End Processes:

Federal Financing

Audit Program

Description

A review of internal controls associated with federal financing is essential, in several State departments, given the significance of this revenue source (and related year-end receivables). Important processes typically include procedures related to:

- Initiating federal draws in a timely manner
- Maintaining accountability over all federal awards and amendments
- Maintaining accountability over all costs financed by federal programs (including indirect cost pools of the department and central control agencies)
- Reconciling federal cash receipts to federal revenues, deferred revenues and receivables in the State of Michigan account structure

The internal auditor must include in its letter of assurance to OFM, a summary-level reconciliation of federal cash draws to federal revenues, receivables, deferred revenues, and unearned receipts (recorded in MAIN) for all major federally financed programs. This reconciliation will provide additional assurance on the accuracy of the department's financial records. The internal auditor must either review (and accept) the work of financial management staff or independently direct the reconciliation. The definition of a "major program" will be as determined by the Michigan Office of the Auditor General. The OAG definition is based on the criteria detailed in OMB Circular A-133.

Federal revenue is earned by expending money on federal programs. Because federal revenue earned is based on expenditures, the department must have a reasonable method of computing and recording federally reimbursable expenditures and the amount of federal funds earned.

Objectives

1. Determine that processes for maintaining accountability over federal awards including the timeliness and accuracy of cash draws are reasonable.
2. To determine if federal accounts receivable and related federal revenue amounts are "measurable," recorded at the proper amounts, and consistently measured.
3. To determine if federal accounts receivable actually exist and represent revenue that the State earned by incurring obligations which has not been collected.
4. To determine if federal revenues are supported by receipts and are recorded properly in MAIN (i.e., appropriate GAAP Source Object within the appropriate fund).
5. Determine if earned federal revenue related to federal accounts receivable was accrued.

How to Identify Population of Transactions

The receipt of federal revenue is done in the same manner as other revenue. The unique identification of it as "federal" revenue is obtained from account coding block assigned by the agency.

However, the Finance Type will be 03 (Federal), which can be obtained from the D23 screen. The GAAP Source/Object (D08) should be either 1020 (From Federal Agencies), 5220 (Federal Grant Revenue), or 1060 (Special Medicaid Reimbursements).

In addition, most agencies separate out their federal programs into distinct and separate D23 Funds. This coding is achieved by use of PCA (Program Cost Account - 26) or Index codes (24), which infer the proper accounting and financial statement roll-up.

You will need to verify the specific coding elements used by your department to account for federal revenues and receivables (i.e., revenues - Comptroller Objects (D10); accounts receivable, unearned receipts payable, and deferred revenue - Comptroller GL Accounts (D31); Fund (D23); Appropriation Number (20); and GAAP Sub-funds (D68).

Technical References

- Administrative Guide to State Government - Procedures 1210.06; 1210.07; 1210.08
- OMB Circular A-133
- State of Michigan Cash Management Improvement Act (CMIA) Agreement
- Office of Financial Management July 22, 1997 Policy Memorandum-Terminal Leave Payments

Audit Steps

1. Document and determine the reasonableness of method(s) used by the department to:
 - Maintain accountability over all federal awards
 - Accumulate federal reimbursable expenditures (both direct and indirect)
 - Account for federal revenues recorded in MAIN
2. Determine the reasonableness of processes used by the department to initiate timely and accurate cash draws from the federal government (including distribution of cash receipts between the prior year receivable and current year revenue). If any departmental programs are specifically identified in the State of Michigan's CMIA agreement (with the federal government), determine the appropriateness of any unique control procedures and reporting associated with these programs.
3. Determine the reasonableness of methods used to reconcile federal cash activity to the State of Michigan financial records. Obtain an estimate of total revenues related to each federal program.
4. Perform a summary-level reconciliation of federal draws to federal revenue, receivables, deferred revenue and unearned receipts in MAIN (for selected programs). Note: federal revenues/receivables should not be recorded based on encumbrances.
5. Consider preparing an analytical review of all MAIN recorded financial data associated with your department's federally financed activities. Identify reasons for significant fluctuations in consultation with departmental financial management staff.